14.0 INVESTOR-OWNED UTILITY (IOU) BENEFITS AND SETTLEMENTS

14.1 Benefits to Regional IOUs

Issue 1

Whether BPA has provided appropriate attention and benefits to residential and rural customers of regional IOUs, and whether an "end results test" applies to BPA's ratemaking.

Parties' Positions

The IOUs argue that BPA should apply an "end results test" to its proposed rates to determine whether the effect of the rates would be fair to the residential consumers of regional IOUs. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 6-7. The IOUs argue that BPA's initial proposal does not meet BPA's policy goals. *Id.* at 7-9. The IOUs argue that BPA's initial proposal frustrates the intent of Congress. *Id.* at 9-13. The IOUs' arguments are reiterated in their brief on exceptions. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 5-13. On the other hand, NRU argues that the IOUs' recommendation of an end results test has no foundation in the Northwest Power Act. NRU Brief, WP-02-B-NI-02, at 30. NRU also argues that the IOUs ignore that Residential Exchange benefits are provided only if the exchanging utility's ASC is greater than BPA's PF Exchange rate, and benefits are also limited by the 7(b)(2) rate test and BPA's right to sell in-lieu power to exchanging utilities. *Id.*

BPA's Position

Neither the Northwest Power Act nor any other statute or case law establishes an "end results test" regarding BPA ratemaking. *See* 16 U.S.C. §839e. Even if such a test were applicable, BPA's rates would satisfy such a test. BPA's initial proposal satisfies BPA's policy goals. BPA's initial proposal does not frustrate the intent of Congress.

Evaluation of Positions

The IOUs argue that BPA should apply an "end results test" to its proposed rates, which would provide that "[i]f the total effect of the rate order cannot be said to be unreasonable, judicial inquiry is at an end," and "[t]he fact that the method employed to reach the result may contain infirmities is not then important and the question is whether the order "viewed in its entirety" meets the requirements under applicable law. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 6-7, quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). First, it is clear that *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), is inapposite. That case involved a proceeding under the Natural Gas Act. *Id.* at 602. The Court specifically reached its conclusions under a "statutory standard" and considered whether the Commission's order "meets the requirements of the Act." *Id.* The Natural Gas Act does not apply to BPA ratemaking. 15 U.S.C. §717(b). Later decisions have applied the end results test to the Federal Power Act, because that Act also requires that rates be "just and reasonable." *See Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1175 (D.C. Cir. 1987). Again, however, the Federal Power Act does not apply to

the development of BPA's wholesale power rates. 16 U.S.C. §824(f); 16 U.S.C. §832a(a). *See Central Lincoln PUD v. Johnson*, 735 F.2d 1101, 1113 n.6 (9th Cir. 1984); *Village of Bergen v. FERC*, 33 F.3d 1385, 1390 (D.C. Cir. 1994). The Northwest Power Act does not apply a just and reasonable test to BPA's wholesale power rates. 16 U.S.C. §839e.

In addition, later cases have allowed greater judicial inquiry into the details of the ratemaking process. *See Permian Basin Area Rate Cases*, 390 U.S. 747, 791 (1968). Other courts have recognized that "[e]xperience has taught that a determination of whether the result is just and reasonable requires an examination of the method employed in reaching that result." *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981). *See Shell Oil Co. v. FPC*, 520 F.2d 1061, 1071 (5th Cir,. 1975); *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1178 (D.C. Cir. 1987); *City of Brookings Municipal Telephone Co. v. FCC*, 822 F.2d 1153, 1164 (D.C. Cir. 1987). Furthermore, even if one assumed, *arguendo*, that an end results test were applicable, BPA's proposed wholesale power rates, as discussed in greater detail below, pass that test.

The IOUs note that BPA established that: (1) neither the Northwest Power Act nor any other statute or case law establishes an end results test for BPA ratemaking; (2) that the Northwest Power Act does not apply a just and reasonable test to BPA's wholesale power rates; and (3) so long as each individual issue is considered and determined on its merits, there is no overall end results test required. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 8. In support of the third proposition cited by the IOUs, they refer to the Draft ROD, WP-02-A-01, at 14-8. BPA found no such discussion at that location. The IOUs argue that BPA admits in the Draft ROD that "[n]evertheless, we are required to reject BPA's constructions of a statute that are inconsistent with the statutes or frustrate the policy Congress sought to implement. *Southern Cal. Edison Co. v. FERC*, 770 F.2d 779, 782 (9th Cir. 1985)." *Id*. Obviously this was not BPA's statement but rather a statement of the United States Court of Appeals for the Ninth Circuit cited by BPA. BPA does not contest the court's statement as a matter of law, but finds it inapplicable to BPA's statutory interpretations in this proceeding. In addition, the IOUs have failed to present the other side of the coin recognized by the court. Immediately preceding the portion of the court's statement cited by the IOUs, the court states:

> We must affirm BPA's action unless it is arbitrary, capricious, an abuse of discretion, or in excess of statutory authority. 16 U.S.C. §839f(e)(2); 5 U.S.C. §707; *CEC*, 831 F.2d, at 1472. This standard of review is deferential to and presumes that agency action to be valid. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 415, 91 S.Ct. 814, 823, 28 L.Ed. 2d 136 (1971). Because BPA drafted the Northwest Power Act, its interpretation of the Northwest Power Act is to be given "great weight" and should be upheld if reasonable. *Aluminum Co. of America v. Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 389-90, 104 S. Ct. 2472, 2479-80, 81 L.Ed. 301 (1981) (ALCOA I); *Aluminum Co. of America v. Bonneville Power Admin.*, 891 F.2d 748, 752 (9th Cir. 1989) (ALCOA II).

California Energy Comm'n v. Bonneville Power Admin., 909 F.2d 1298, 1306 (9th Cir. 1990).

The IOUs argue that BPA's actions should not frustrate the intent of Congress. IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 9. Also, the IOUs argue that BPA cannot argue that each individual decision was reasonable if it does not add up to a reasonable result. *Id*. As explained in great detail in BPA's discussion of the issues in this ROD, BPA's actions are consistent with Congressional intent, and BPA's decisions produce reasonable results. These results may not produce what a particular customer class would like, but the Northwest Power Act does not prescribe specific amounts of benefits for each customer class. For example, Residential Exchange benefits for the IOUs and other exchanging utilities may be limited by section 7(b)(2) of the Northwest Power Act, which Congress designed to establish a rate ceiling for BPA's preference customers. *See* 16 U.S.C. §839e(b)(2).

The IOUs also argue that BPA is incorrect in saying that "wholesale rate parity" means exactly what it says--parity of wholesale rates charged by BPA to its preference and exchange customers (subject to the section 7(b)(2) rate test). IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 9, n. 26. Instead, the IOUs argue that it means parity between an IOUs' average cost of power and BPA's wholesale rate for power to public agencies and cooperatives. The IOUs' argument is unclear. If the IOUs' reference is to the IOUs' ASCs, then their argument is incorrect. If wholesale rate parity occurred where a utility's ASC is equal to the PF Exchange rate, this would result in the payment of *no* REP benefits to the IOU on behalf of its residential consumers. Such a concept of wholesale rate parity would eliminate the REP. If the IOUs' argument is that wholesale rate parity occurs where a utility's ASC is equal to the PF Preference rate, this would also make no sense. Because in this rate case, for example, the PF Preference rate is lower than the PF Exchange rate, this approach also would result in the payment of *no* REP benefits to the IOU on behalf of its residential consumers. This concept of wholesale rate parity also would eliminate the REP. BPA's interpretation of wholesale rate parity is correct.

The IOUs cite *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1178 D.C. Cir. (1987) for the proposition that an order cannot be justified simply by showing that each of the choices underlying it was reasonable, but that those choices must add up to a reasonable result. IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 10. *Jersey Central*, which is based on review under the Federal Power Act, is inapposite. As noted in greater detail above, neither the Natural Gas Act nor the Federal Power Act apply to BPA's wholesale power ratemaking and do not impose an end results test on BPA.

The IOUs also argue that BPA's rates are subject to the Administrative Procedure Act standards of review. IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 10. As demonstrated by the comprehensive discussion of the issues in this case, BPA's decisions are in accordance with law and with applicable standards for judicial review. The merits of each issue are addressed in the section of this ROD discussing that issue and in other relevant sections. The IOUs also argue that BPA's rate proposal creates such an unjustifiable disparity that it would violate the Fifth Amendment of the U.S. Constitution by denying equal protection and due process to the residential and small farm consumers of the Northwest utilities. IOU Ex. Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 10. However, the IOUs' constitutional arguments consist of a single sentence that generally asserts these alleged violations. *Id.* Other than this bare assertion, the IOUs make no demonstration of how rate disparity rises to the level of a constitutional violation. Similarly, the IOUs do not demonstrate how applicable standards that

pertain to establishing equal protection and due process violations have been met. Nevertheless, it is clear their arguments are without merit. First, the relevant due process issue under the Fifth Amendment of the U.S. Constitution would be *procedural* due process, not substantive due process. Given the lengthy procedural schedule in this case, the extensive opportunities for discovery, the filing of direct testimony, the filing of rebuttal testimony, the extensive opportunity for cross-examination, the opportunity for initial briefs and briefs on exceptions, the opportunity for oral argument, and the other procedural features of this proceeding, BPA's rate proposal does not deny the residential customers of exchanging utilities procedural due process. Second, with respect to the IOUs' equal protection claim, exchanging utilities are a class of customers defined in the Northwest Power Act. Preference customers are a class of customers defined in the Northwest Power Act. DSI customers are a class of potential customers defined in the Northwest Power Act. The Northwest Power Act prescribes the manner in which such classes have access to the benefits of the Federal system. As noted previously, the benefits provided to the IOUs and preference utilities under the REP are subject to change based upon the utilities' ASCs and the level of BPA's PF Exchange rate. The Act establishes the section 7(b)(2) rate test for preference customers to protect such customers from, among other things, the costs of the REP. If the rate test triggers, BPA must allocate costs to other non-preference rates, including the PF Exchange rate. When the PF Exchange rate increases, REP benefits decrease because the gap between the utility's ASC and BPA's PF Exchange rate grows smaller. Changes in REP benefits due to these statutory requirements are not denials of the IOUs' rights.

The IOUs argue that BPA's policy witness said the first of BPA's four goals was to "spread the benefits of the FCRPS as broadly as possible with special attention given to residential and rural customers of the region." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 7. The IOUs argue that BPA's witness agreed that BPA's goal of providing "special attention to the residential and rural customers" was required by statute. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 7. Tr. 119-20. This statement requires clarification. IOU counsel asked whether "BPA is required by statute to emphasize residential and rural customers." Tr. 119. This is a legal issue. BPA's witness Mr. Burns replied by noting the existence of the REP. *Id.* BPA does not dispute that the REP provides benefits to regional residential consumers. BPA's witness, Mr. Burns, however, is not a lawyer and is not able to address issues regarding the law. His testimony on this matter must therefore, be given little weight. Whether BPA is required by law to emphasize residential and rural customers must be found in the Northwest Power Act or other applicable legislation. BPA's review of applicable law has not located a provision that states what the IOUs allege. The Bonneville Project Act states that BPA's rate schedules "shall be fixed and established with a view to encouraging the widest possible diversified use of electric energy." 16 U.S.C. §832e. This provision, however, does not state that "special attention [be] given to residential and rural customers of the region." The Bonneville Project Act also provides that:

> In order to insure that the facilities for the generation of electric energy at the Bonneville Project shall be operated for the benefit of the general public, and particularly of domestic and rural consumers, the administrator shall at all times give preference and priority to public bodies and cooperatives.

16 U.S.C. §832c(a). Again, this provision does not require special attention for the residential and rural consumers of IOUs, but rather of BPA's preference customers.

The IOUs argue that under BPA's initial proposal, the dollar benefits to residential and rural customers of the IOUs would be approximately $140 million a year. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 8; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 5-6. The IOUs argue that this means that 60 percent of the residential and small farm customers of the region will receive less than 23 percent of the benefits of the Federal hydropower system. *Id.* The IOUs argue that if BPA benefits reach $1 to $2 billion per year, it would mean that the IOUs' residential consumers would receive only 7 to 14 percent of total benefits to the region. *Id.* This argument must be viewed in the context of the statutory framework that provides benefits to all of BPA's customers. The primary law establishing these obligations is the Northwest Power Act. Implementation of the directives of the Northwest Power Act results in benefits of the Federal power system that flow to BPA's customers and, where applicable, to retail consumers of those customers. One of the most fundamental requirements of the Northwest Power Act is that public bodies and cooperatives have preference and priority to the purchase of Federal power to meet their net requirements. 16 U.S.C. §832(a); 16 U.S.C. §839c(a). This power is used to serve all requirements loads of such preference customers, including residential, commercial, and industrial loads. Preference customers also pay the PF Preference rate for their power purchases. BPA's rate directives establish the manner in which BPA must allocate costs in establishing the PF rate, which applies to BPA's preference customers and utilities participating in the REP. 16 U.S.C. §839e(b)(1). The PF rate for utilities participating in the REP is subject to adjustment pursuant to 7(b)(2) of the Northwest Power Act, 16 U.S.C. §839e(b)(2), which is discussed in greater detail in ROD chapter 13. Due to the cost allocation directives of section 7 of the Northwest Power Act, and the fact that FBS power can be priced well below other sources of power, the PF Preference rate is currently BPA's lowest rate for firm power requirements service. Therefore, under the law, BPA's preference customers receive substantial benefits from the Federal power system by being able to purchase their net requirements at the PF Preference rate.

IOUs may benefit in a number of ways from the Northwest Power Act. First, like BPA's preference customers, IOUs may place their net requirements load on BPA. 16 U.S.C. §839c(b)(1). The rate directives for IOUs' requirements power, unlike those for BPA's preference customers, are contained in section 7(f) of the Northwest Power Act, which generally results in NR rates that are higher than the PF Preference rate. Due to the level of the NR rate, BPA has forecasted few requirements sales under the NR rate to IOUs for the rate period. (A discussion of requirements sales to IOUs as part of a settlement of the REP is discussed later in this section.) A second way in which IOUs benefit from the Northwest Power Act is the REP. 16 U.S.C. §839c(c). Under the REP, BPA "purchases" power from each participating utility at that utility's ASC. Boling and Doubleday, WP-02-E-BPA-30, at 2. The Administrator then offers, in exchange, to "sell" an equivalent amount of electric power to the utility at BPA's PF Exchange power rate. *Id.* The amount of power purchased and sold is the qualifying residential and small farm load of each utility participating in the REP. *Id.* The Northwest Power Act requires that the net benefits of the REP be passed through directly to the residential and small farm customers of the participating utilities. *Id.* Under the normal implementation of the REP, no actual power is transferred either to or from BPA. *Id.* The "exchange" has been referred to as a "paper" transaction, where BPA provides the participating utility cash payments that represent the difference between the power "purchased" by BPA and the less expensive power "sold" to the participating utility. *Id.*

As noted above, under the REP, IOUs pay the PF Exchange rate for power purchased from BPA. This rate, however, may not be the same level as the PF Preference rate. The Northwest Power Act established what is called the 7(b)(2) rate test, which is discussed in greater detail in ROD chapter 13. 16 U.S.C. §839e(b)(2). This test is designed to protect preference customers from certain costs incurred under the Northwest Power Act, including Residential Exchange costs. If the 7(b)(2) rate test does not trigger, the PF Preference rate and the PF Exchange rate are equal. If the 7(b)(2) rate test triggers, however, the PF Exchange rate is subject to a surcharge and is higher than the PF Preference rate. The lower the PF Exchange rate, the higher the exchange benefits. The higher the PF Exchange rate, the lower the exchange benefits. This is the manner in which rates must be established by BPA under the Northwest Power Act. Where, as in the current rate case, the 7(b)(2) rate test triggers, it is not at all surprising that consumers of preference customers would receive greater "benefits" than the IOUs' residential consumers. This is the way that the Northwest Power Act works. In years when the 7(b)(2) rate test did not trigger, as has occurred periodically over the last 15 years, the IOUs receive greater benefits. In years when the 7(b)(2) rate test triggers, the IOUs receive lesser benefits. In summary, while different customer classes may receive greater or lesser benefits of the Federal system in any particular rate period, this is a result of the implementation of the directives of the Northwest Power Act. While it is unfortunate that some customer classes may receive greater benefits than other customer classes, BPA cannot unilaterally change the law. *See* NRU Brief, WP-02-B-NI-02, at 30.

The IOUs argue that BPA witness Burns stated that he did not know if anyone at BPA compared the end result of the rate test to Congressional intent. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 8. The IOUs argue that as BPA's senior policy witness in this case, it was up to Mr. Burns to examine the end result. *Id.* at 8-9. The IOUs fail to recognize, however, that the determination of Congressional intent is a legal matter. As noted previously, because Mr. Burns is not a lawyer, he would not be able to provide a legal judgment regarding such intent. In addition, as previously noted, there is no end results test applicable to BPA's ratemaking. Furthermore, BPA has been developing rates under the Northwest Power Act for nearly 20 years. In each rate case BPA has conducted, BPA has implemented the same statutory rate directives as in the previous rate case, subject to the changes in the rate directives beginning in 1985. In addition, BPA reviewed the Northwest Power Act and its legislative history in developing BPA's Legal Interpretation of 7(b)(2) in 1984, b-2-84-FR-03. BPA also reviewed the Northwest Power Act and its legislative history in developing BPA's 7(b)(2) Implementation Methodology in 1984, b-2-84-F-02. BPA also has conducted the 7(b)(2) rate test in every rate case since 1985, except in the few cases where the rate case was settled and the test was not performed. In summary, BPA is extremely familiar with the 7(b)(2) rate test and the Congressional intent behind the test. This makes a comparison of the results of the rate test with Congressional intent an inherent part of the rate test. BPA's extensive review of the legislative intent of the 7(b)(2) rate test is found elsewhere in this ROD. After reviewing BPA's implementation of the 7(b)(2) rate test in the current rate case, the end result of the rate case and BPA's proposed rates are perfectly consistent with the Northwest Power Act, the legislative history of the Northwest Power Act, and other applicable rules.

The IOUs' basic premise, however, is troubling. BPA develops its rates in accordance with the Northwest Power Act, other applicable legislation and other rules (*e.g.*, the 7(b)(2)

Implementation Methodology). As BPA noted, "[e]ach issue regarding the 7(b)(2) rate test is considered and determined on its merits. Similarly, other rate case issues must be determined on their merits." Boling and Doubleday, WP-02-E-BPA-53, at 17. The IOUs' argument appears to be that instead of considering and determining each issue on its merits, BPA should make a subjective judgment regarding whether any party is receiving a level of benefits from BPA that is somehow appropriate. The IOUs apparently argue that if a party is not receiving benefits that are somehow appropriate, BPA should not consider and determine each issue on its merits, but instead should make decisions it does not believe are correct in order to favor the parties that are allegedly not receiving enough benefits. This approach is simply wrong and contrary to the Northwest Power Act. 16 U.S.C. §839e.

The IOUs argue that, "in a striking admission," BPA's policy witness acknowledged that BPA's initial proposal would produce lower benefits to residential and rural consumers of IOUs than to the commercial and industrial customers of government-owned utilities and co-ops. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 9. Tr. 132. However, the IOUs' transcript citation presents substantial ambiguity. The transcript states:

> Q. So I take it then, based upon what you have just said, that BPA's initial proposal will produce lower rates and benefits to residential and rural customers of IOUs than to the commercial and industrial customers of government-owned utilities and co-ops?
>
> A. (Mr. Burns) Basically, on a per person basis or average, yes. Yes.

Tr. 132.

The first ambiguity is in the question asked by counsel for the IOUs. The question asks whether BPA's initial proposal will produce "lower rates and benefits" to residential and rural customers of IOUs. *Id.* This is an oxymoron. If the initial proposal produces lower rates for residential and rural customers, *i.e.*, a lower PF Exchange Program rate, there would be greater benefits for residential and rural customers because there would be a larger gap between the exchanging utility's ASC and the PF Exchange Program rate. In addition, BPA does not establish rates for the residential consumers of IOUs, but rather, rates for the IOUs that implement the REP. BPA also does not establish rates for commercial and industrial customers of government-owned utilities and co-ops, but rather, rates for the publicly owned utilities that serve the companies. Thus, the question asked is unclear. In addition, the witness's answer is ambiguous because, while asked about rates and benefits to residential and rural consumers, *i.e.*, people, compared to commercial and industrial customers, *i.e.*, companies, the witness answered only with regard to a "per person" basis or average. *Id.* Even assuming, *arguendo*, that the IOUs' characterization of this exchange were correct, this is hardly a "striking" admission.

Under the law, BPA is required to offer power first to public bodies and cooperatives, known as preference customers. 16 U.S.C. §832(a); 16 U.S.C. §839c(a). This power is provided to serve all requirements loads of such preference customers, including residential, commercial, and industrial loads. Preference customers pay the PF Preference rate for their power purchases. Commercial and industrial customers of publicly owned utilities benefit indirectly from the sales

to their publicly owned utilities at the PF Preference rate. This rate is currently BPA's lowest firm power requirements rate. IOUs, however, participate in the REP. Under that program, IOUs pay the PF Exchange rate for power purchased from BPA, which is compared with the utility's ASC to determine exchange benefits. Because there are IOUs with ASCs lower than BPA's PF Exchange Program rate (sometimes due to a utility's own cheap hydro resources), consumers of such IOUs receive no exchange benefits. Thus, a commercial or industrial customer of a publicly owned utility, because it benefits indirectly from the PF Preference power purchased by its publicly owned utility, would benefit more than consumers of IOUs with ASCs below the PF Exchange rate. Even for IOUs with ASCs above the PF Exchange rate, the PF Exchange rate may be higher than the PF Preference rate due to the 7(b)(2) rate test. The higher the PF Exchange rate, the lower the exchange benefits. This is the manner in which rates must be established and the program implemented by BPA under the Northwest Power Act. Where, as in the current rate case, the 7(b)(2) rate test triggers, commercial and industrial customers of preference customers would receive benefits from their publicly owned utility's PF Preference power purchases. The IOUs' residential consumers would receive benefits based on the relationship of their utility's ASC to the PF Exchange Program rate. There is no analysis in the record to compare the benefits for any particular commercial or industrial customer of a publicly owned utility with a particular residential consumer of an exchanging utility. However, there would likely be differences. This is the way that the Northwest Power Act works. In years when the 7(b)(2) rate test did not trigger, as has occurred in past years, the IOUs received greater benefits. In years where the 7(b)(2) rate test does trigger, the IOUs receive lesser benefits.

The IOUs discuss Congressional intent in establishing the REP. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 9-13; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 11-12. BPA discusses the background of the REP in ROD chapters 11 and 13. Much of BPA's description is consistent with the IOUs' description. There are, however, a number of clarifications of the IOUs' arguments that should be noted. First, omitted from this discussion in the IOUs' brief is a discussion of Congressional intent in establishing the 7(b)(2) rate test. As noted in BPA's discussion of the background of the 7(b)(2) rate test, there are direct connections between these two features of the Northwest Power Act. BPA discusses this subject in ROD chapter 13. In addition, the IOUs cite no provision that establishes a particular level of Residential Exchange benefits. Instead, there are general statements in legislative history that the Northwest Power Act would provide "a share in the economic benefits of the lower-cost Federal system for the residential consumers of the non-preference customers," and would "extend the benefits of low-cost federal power to consumers served by investor-owned utilities." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 10-12. These statements, however, establish no particular amount of benefits or test for benefits. Instead of relying on the Northwest Power Act, where no particular level of benefits is guaranteed, the IOUs quote a policy specialist from the Washington Utilities and Transportation Commission, an entity, like all regional state public utility commissions, that shares the IOUs' interest in receiving as much money as possible from the Federal Government under the REP. *Id.* at 12. While the policy person stated her opinion that the residential consumers of IOUs are "provided equal access to the benefits of the Federal hydropower system through an exchange program," this statement is clearly inconsistent with the Northwest Power Act itself, which nowhere specifies that the IOU benefits provided under the REP would be equal to the benefits provided to BPA's preference customers. Furthermore, after the detailed statutory and

legislative history analysis in the introduction to chapter 13, BPA concluded that the Northwest Power Act expressly contemplates that section 7(b)(2) could completely eliminate exchange benefits for utilities whose ASC rate was less than BPA's PF Exchange rate.

Similar arguments based on this witness's testimony were refuted during the hearing. An IOU, citing this witness's testimony regarding Appendix B of the Report of the Senate Committee on Energy and Natural Resources, S. Rep. 272, 96th Cong., 1st Sess. (1979), claimed that the Northwest Power Act intended that IOUs' residential consumers should receive greater monetary benefits under the REP than proposed by BPA. Gaines, WP-02-E-PS-01, at 7-8. The Joint DSIs noted that this argument was unfounded. Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 15-16. The witness cited by the IOUs selected only elements of forecasts performed 20 years ago of events that were then 15 years in the future. *Id.* The witness compared those selected elements to events that actually occurred. *Id.* The witness's testimony ignored the faulty underlying assumptions that have rendered moot the forecasts done in 1979 during Congressional consideration of the Northwest Power Act. *Id.* To argue that there is some significance to the fact that the 1979 forecasts predicted that the Residential Exchange benefits would be higher than actually occurred and that the DSI rates were forecasted to be higher than actually determined, without exploring all of the assumptions that went into that forecast, is disingenuous. *Id.* Among the expectations in 1979 are: preference customer loads on BPA that were forecasted to be more than twice the 1997 loads, IOU loads were forecasted to be 25 percent higher, 40 percent of IOU loads were assumed to be served with BPA power, DSI loads on BPA were expected to be 250 percent of the actual 1997 loads, the FBS was forecasted to cost 60 percent of its actual cost in 1997 and to be 20 percent larger in size, BPA was forecasted to acquire 9,800 MW more new resources than the 230 MW BPA actually acquired, the actual cost of the new resources was 60 percent of the 1979 forecast, and Residential Exchange loads were about one-half of forecasted loads. *Id.* Actually, about the only significant forecast from 1979 that proved correct was the cost of exchange resources: the forecasted cost was 33.7 mills/kWh, while the actual cost was 33.3 mills. *Id.* These changes radically affected BPA's rates. *Id.* The difference between the forecast of DSI rates in 1979 and the actual rates in 1996 is directly attributed to the vast difference in the assumptions used to make these forecasts and actual developments. *Id.* None of these reasons relates to the 7(b)(2) rate test, but rather the amount of load growth in the Northwest and the resource acquisitions made by BPA to serve the load growth. *Id.* Furthermore, Appendix B, which was relied on by the witness, was incorporated in the Senate Report with reservations. *Central Lincoln PUD v. Johnson*, 735 F.2d 1101, 1123 (9th Cir. 1984).

The IOUs also cite *Public Utility Commissioner of Oregon v. Bonneville Power Admin.*, 767 F.2d 622, 624 (9th Cir. 1985) for the proposition that "[o]ne of the goals of the Northwest Power Act is to ensure that residential customers served by Northwest IOU's have wholesale rate parity with residential customers served by publicly owned utilities and public cooperatives, BPA's preference customers." This case did not involve a substantive ruling on the REP. Instead, the court merely held that it lacked jurisdiction to review the case because the action was required to be final before it was reviewable. *Id.* at 628. More important, however, is that the term "wholesale rate parity" means exactly what it says: parity of wholesale rates charged by BPA to its preference and exchange customers. This is achieved in the Northwest Power Act by providing that the wholesale power rates for BPA's sales to its preference customers and the

wholesale power rates for BPA's sales to IOUs for the REP will be at the same rate, that is, the PF rate. This basic point, however, is not always true, because the Northwest Power Act also includes section 7(b)(2), which can result in an allocation of costs such that the PF rate paid by exchanging utilities is higher than the PF rate paid by preference customers.

The IOUs argue that providing 60 percent of the region's citizens with less than 23 percent of the Federal power benefits has led to increased pressure to form government-owned utilities to take over areas served by IOUs. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 12. Federal power benefits are provided to IOUs in large part through the REP. Boling and Doubleday, WP-02-E-BPA-53, at 21. REP benefits are determined by comparing an exchanging utility's ASC with BPA's PF Exchange Program rate. *Id.* The PF Exchange Program rate level is determined in large part by incorporating the results of the 7(b)(2) rate test. *Id.; see* 7(b)(2) Rate Test Study, WP-02-E-BPA-06; Kaptur *et al.*, WP-02-E-BPA-34; and Kaptur *et al.*, WP-02-E-BPA-56. Each issue regarding the 7(b)(2) rate test is considered and determined on its merits. Boling and Doubleday, WP-02-E-BPA-53, at 21. It is not BPA's intent to create pressure to form government-owned utilities or to reignite battles between public and private power. *Id.* The IOUs argue that Congress had the right remedy in the REP: rate parity. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 13. Wholesale rate parity, however, as noted above, is something that is already implemented by BPA in each rate case. If there is no 7(b)(2) trigger, there is parity in wholesale rates. If there is a 7(b)(2) trigger, there is not exact rate parity. This is required by section 7(b)(3) of the Northwest Power Act. 16 U.S.C. §839e(b)(3).

The IOUs argue that BPA's initial rate proposal fails to meet the goal of spreading the benefits of the FCRPS as broadly as possible, with special attention given to the region's residential and rural customers. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 13; IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 13. In addition to the points noted above, however, BPA is meeting its aforementioned goal. BPA's rate proposal, as explained throughout this ROD, provides benefits of the Federal power system to all of BPA's customer groups and other interest groups. As reflected in their briefs, the customer groups disagree with each other on the benefits being provided to each other customer group. The IOUs believe that they are not receiving enough benefits and ardently oppose elements of BPA's proposed rates for the DSIs and preference customers. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01. Alcoa and Vanalco, two DSIs, believe they are not receiving enough power or proper rates and that BPA should not sell power to the IOUs at the RL rate. Alcoa/Vanalco Brief, WP-02-E-B-AL/VN-01. The preference utilities argue that they are being treated unfairly in BPA's proposed rates, and some preference groups oppose power sales to the IOUs at the RL rate. WPAG Brief, WP-02-B-WA-01. While benefits are being spread to each customer group, it is difficult to ensure that any or all of such groups will be happy with the benefits they receive.

BPA established its Subscription Strategy with a number of goals: to spread the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region; to avoid rate increases through a creative and business-like response to markets and additional aggressive cost reductions; to allow BPA to fulfill its fish and wildlife obligations while assuring a high probability of U.S. Treasury payment; and to provide market incentives for the development of conservation and renewables as part of a broader BPA leadership role in the

regional effort to capture the value of these and other emerging technologies. *See* Subscription Strategy, at 3-4. BPA believes that its proposed rates achieve these goals. BPA's goal of spreading the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region, is implemented in the Subscription Strategy by BPA's proposed settlements of the REP with regional IOUs. *Id.* at 8-10, 16-17. BPA's rate case has proposed rates that would implement these proposed settlements. Furthermore, BPA's forecasted Residential Exchange benefits to the IOUs comprise approximately $37 million per year during the rate period. Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 91. In providing special attention to residential and rural customers of the IOUs and giving them an additional option in access to Federal benefits, BPA forecasted exchange settlement benefits to the IOUs that total approximately $140 million per year during the rate period. Tr. 122. To suggest that BPA is not giving special attention to the region's residential and rural customers of IOUs is simply incorrect.

Decision

Neither the Northwest Power Act nor any other statute or case law establishes an "end results test" regarding BPA ratemaking. See 16 U.S.C. §839e. Even if such a test were applicable, BPA's rates would satisfy such a test. BPA is providing special attention to residential and rural customers and providing benefits in a manner consistent with law. BPA is properly providing benefits of the Federal system to IOUs through implementation of the REP and through proposed Subscription settlements of that Program. BPA's decisions comply with statutory standards for ratemaking and statutory standards for judicial review.

14.2 Residential Load Firm Power (RL) Rate

Issue

Whether BPA is required to establish an RL rate that is of general applicability and that is approximately equal to the PF Preference rate.

Parties' Positions

The IOUs argue that the Subscription ROD states that BPA would develop rates for power products that are approximately equal for all customer groups. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 61-63. They also argue that this is consistent with BPA's obligation under section 7(b) of the Northwest Power Act to establish rates of general applicability. *Id.* The IOUs argue that BPA has not complied with these conditions because there is a significant difference in the products offered to different customer groups at those rates. *Id.* The IOUs reiterate these issues in their brief on exceptions. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 44-46.

BPA's Position

BPA's Subscription Strategy did not make any final rate decisions regarding rates being approximately equal for all customer groups. BPA's rates satisfy the Northwest Power Act's requirements regarding the establishment of rates of general applicability. The power product available for the IOU REP settlements is described in BPA's Subscription Strategy, and the rate for that product is the same rate that would be paid for that product by a preference customer.

Evaluation of Positions

The IOUs argue that the Subscription ROD states that BPA would develop rates for power products that are approximately equal for all customer groups. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 61. BPA's Subscription ROD, however, does not state that BPA *would* develop approximately equal rates, but rather that BPA *proposed* to develop such rates. Subscription ROD, at 8. Discussions of rates in the Subscription Strategy and ROD consistently note that BPA is not making any final rate decisions in the Subscription Strategy. BPA's Subscription Strategy did not state that the IOU settlement sales would be charged a "PF-equivalent" rate, but rather, BPA's expectation was that "[t]hese sales [to IOUs] will be at a rate approximately equal to the PF Preference rate, *subject to establishment in BPA's rate case and consistent with BPA's rate directives*." *Id.;* Subscription Strategy, at 16 (emphasis added). The Subscription ROD also notes that:

> Subscription power sales (*i.e.*, power contracts signed during the Subscription window) to public agency customers will be at the PF rate. Subscription sales to IOUs and DSIs would be at *applicable* rates, which are *expected* to be approximately equivalent to the PF rate, *subject to a section 7(i) hearing and BPA meeting its statutory rate directives*.

Subscription ROD, at 9 (emphasis added).

BPA's statements in the Subscription Strategy and ROD were not final rate decisions. Final rate decisions can be made only in a section 7(i) hearing process. 16 U.S.C. §839e(i). BPA's discussions on rate issues in the Subscription process were limited to discussions of what might be included in BPA's initial proposal and then might be subject to change in the formal hearing. In any event, in BPA's initial proposal, as discussed in greater detail below, rates for relevant firm power sales are approximately equal for all customer groups.

The IOUs argue that the concept that BPA would develop rates for power products that are approximately equal for all customer groups is consistent with BPA's obligation under section 7(b) of the Northwest Power Act to establish rates of general applicability for power sold to meet the requirements loads of government-owned and cooperative customers and part of the residential loads of IOUs. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 61-62. BPA disagrees with the IOUs' argument that BPA's obligation to establish rates of general applicability necessarily obligates BPA to make these rates approximately equal for all customer groups. section7(b)(1) of the Northwest Power Act provides that "[t]he Administrator shall establish a rate or rates of general application for electric power sold to meet the general

requirements of public body, cooperative, and Federal agency customers within the Pacific Northwest, and loads of electric utilities under section 839c(c) of this title . . . " 16 U.S.C. §839e(b)(1). This provision relates only to the establishment of rates that apply to BPA's net requirements sales to preference customers, at the PF Preference rate, and BPA's sales to utilities under the REP, at the PF Exchange rate. Under the REP, IOUs pay the PF Exchange rate for power purchased from BPA. This rate, however, may not be the same level as the PF Preference rate. The Northwest Power Act established what is called the 7(b)(2) rate test, which is discussed in greater detail in ROD chapter 13. 16 U.S.C. §839e(b)(2). This test is designed to protect preference customers from certain costs incurred under the Northwest Power Act, including Residential Exchange costs. If the 7(b)(2) rate test does not trigger, the PF Preference rate and the PF Exchange rate are equal. If the 7(b)(2) rate test triggers, however, the PF Exchange rate is subject to a surcharge and is higher than the PF Preference rate. Even though the PF Preference and PF Exchange rates differ, they are rates of general applicability for the relevant sales to BPA's customer classes. Therefore, the fact that BPA develops rates of general application for sales to preference customers and sales to exchanging utilities, respectively, does not mean that those rates will be approximately equal.

The IOUs argue that BPA has not complied with the above-noted alleged conditions because there is a significant difference in the products offered to different customer groups at those rates. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 62. First, to the extent the IOUs are arguing that BPA's rates for power products should be approximately equal for all customer groups, it should be noted that the base rates for BPA's customer groups for primary Subscription sales are approximately equal. That is, the level of the PF Preference rate is approximately equal to the rate for the Subscription product proposed for the IOUs in BPA's Subscription Strategy, and both of these are approximately equal to the rate BPA is charging for the first 990 aMW of Subscription sales to the DSIs. In BPA's initial proposal, the monthly diurnal energy rates for the PF Preference and RL rates are equal. *See* Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 101. The monthly diurnal energy IP rates calculated for the initial IP load of 990 aMW are only 1.82 mills/kWh higher than the corresponding PF Preference and RL rates. *Id.* The IP energy rates are higher due to the implementation of the "floor rate test" as prescribed by section 7(c)(2) of the Northwest Power Act. *Id.*; 16 U.S.C. §829e(c)(2). The monthly demand charges are the same for all major firm power rates: PF Preference, RL, and IP. *Id.*

To the extent that the IOUs are arguing that the requirement of general applicability in section 7(b)(1) of the Northwest Power Act somehow requires that the PF Preference rate and the RL rate must be approximately equal, such an argument is misplaced. First, as noted above, section 7(b)(1) applies only to sales to preference customers under the PF Preference rate and sales to exchanging utilities at the PF Exchange rate. It does not apply to the RL rate. The RL rate is a special firm net requirements rate that applies only to sales from BPA offered as part of a settlement of the REP. The RL rate is established under section 7(f) of the Northwest Power Act, not section 7(b)(1). *See* 16 U.S.C. §839e(f); 16 U.S.C. §839e(f). Rates of general application established under section 7(b)(1) of the Northwest Power Act do not include rates such as the RL rate, which is established under section 7(f) of the Northwest Power Act.

The IOUs also argue that BPA's initial proposal offers a 24-hour flat-block power product at the RL rate to the IOUs and offers shaped power (including a flat-block power product with some shape) to preference customers at the PF Preference rate. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 62. First, it must be noted that BPA's proposed Subscription settlement sales to IOUs were consistently described in BPA's Subscription Strategy. BPA's Subscription Strategy notes that:

> In Subscription, BPA proposes a settlement [of the REP] in which residential and small farm loads of the IOUs would be assured access to the equivalent of 1,800 aMW of Federal power for the 2002-2006 period. Of this amount, at least 1,000 aMW will be met with actual BPA power deliveries. The remainder may be provided through either a financial arrangement or additional power deliveries, depending on which approach is more cost-effective for BPA.
>
> BPA and each IOU will negotiate the physical and financial components of the Subscription amount, by year, in the negotiated subscription settlement contracts. Any cash payments will reflect the difference between the market price of power forecasted in BPA's rate case and the rate used to make such Subscription sales. The actual power deliveries for these loads will be in equal hourly amounts over the period . . .

Subscription Strategy at 9. The Subscription Strategy also states that:

> BPA is also making an offer to the IOUs for settlement of the REP comprised of a specified amount of power and monetary payments. The terms and conditions of the settlement proposal are prescribed in order to establish what BPA feels is an appropriate value for the settlement of the REP. Thus, most of the service alternatives available to preference customers continue to be available to the IOUs under traditional requirements contracts and rate schedules. The Subscription settlement power sales, however, are available only under the prescribed conditions.

Id. at 45.

The Subscription Strategy then notes that "the actual power deliveries for the residential and small farm loads of IOUs will be in equal hourly amounts over the contract period." *Id.* In addition, the Subscription Strategy states:

> Some parties argue that BPA should show flexibility in the shape of the sales to the IOUs for their residential and small farm consumers. In determining the shape of sales to the IOUs, however, BPA must view the shape of all BPA sales to customers and the impact of the shape of such sales on BPA's system. BPA anticipates meeting substantial loads of preference customers which have shaping needs throughout the year. BPA cannot operate as economically or efficiently as desired if all loads have changing load shapes. There are operational benefits to BPA of customers taking energy around the clock, all year, without a significant

> amount of variation. Because BPA desires to operate its system efficiently, BPA is making this shape available to the IOUs. This will enable BPA to make direct power sales to the IOUs for their residential and small farm consumers while at the same time meeting the operational need of selling a significant flat-block of energy to regional loads. Further, BPA observes that its service to residential and small farm loads will be only a portion of the utility's total load, and such loads have baseload needs that BPA would be able to serve in this manner. It is important to note that the IOUs may request shaping services or other power products from BPA under the applicable rate schedule.

Id. at 46.

It is therefore clear that a 24-hour flat-block sale was precisely the type of product that the Subscription Strategy envisioned would be offered to IOUs in the proposed Residential Exchange settlements. BPA should therefore charge a price that applies to such a sale. This is what BPA has done. BPA's HLH and LLH energy rates (for both the RL and PF Preference rates) were derived by adjusting the monthly and diurnal energy prices from the Marginal Cost Analysis Study, WP-02-E-BPA-04, to assure that only the revenue requirement is collected. This is done because forecasted market energy prices would over-collect BPA's revenue requirement. Monthly HLH and LLH energy rates from the Marginal Cost Analysis Study, WP-02-E-BPA-04, were reduced proportionately until estimated revenues from energy charges equaled the balance of BPA's revenue requirement. Keep *et al.*, WP-02-E-BPA-17, at 14. During this process, the RL rate and the revenues forecasted under the RL rate were calculated assuming a flat annual load. *See* Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 94.

The IOUs argue that the shaped block offered to preference customers is a more valuable product than the 24-hour flat-block product offered to the IOUs. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 62. The IOUs argue that the 24-hour flat-block product has the lowest risk and lowest cost of service of all BPA products, while the shaped product follows load by the hour and the minute and has the highest risk and highest cost of service of any of the core Subscription products. *Id.* The IOUs argue that the 24-hour flat-block product is BPA's least expensive and most predictable product, because it has no hourly difference across the period of delivery. *Id.* They argue that, by contrast, shaped products present unpredictable variations in service obligations and subject BPA to market price exposure. *Id.* While BPA agrees that the way a customer takes power affects the value of that power, BPA disagrees with the IOUs' argument that the PF Preference and RL rates are dissimilar because of the products available under each. Providing shaped requirements service, *i.e.*, full and partial requirements service, does cost more to serve than a flat block. Keep *et al.*, WP-02-E-BPA-43, at 6. Nevertheless, the combination of the demand charge and the product-specific billing determinant equitably recovers the costs for these services. *Id.* A flat block and a shaped load pay different effective rates that reflect the different costs to serve. *Id.*

The IOUs argue that the PF and RL rates are based on the same demand and energy charges despite the fact that customers receiving flat-block power under the RL rate must incur additional costs to meet actual load. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 63. As stated

above, lower-valued products purchased from BPA have lower costs than higher-valued products purchased from BPA. Any customer, whether an IOU or preference customer, taking a flat-block product would incur the same additional costs to meet actual load. In addition, as noted previously, the Subscription Strategy described the product that would apply to settlements of the REP with IOUs. This is a specific product with a specific rate for a specific settlement. As noted in BPA's testimony, the rate level for the settlement sales supports the proposed value of the settlement of the REP with regional IOUs. *See* Doubleday *et al*., WP-02-E-BPA-44, at 13.

In summary, the IOUs argue that the PF and RL rates are not approximately equal rates because the values of the products are not approximately equal. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 63. As noted above, a flat-block product purchased under the RL rate would cost an IOU exactly the same, on average, as a flat-block product purchased under the PF rate by a preference customer. The preference customer has the option to buy PF products of higher value, but only at a higher average price. BPA's rates are cost-based, however, and BPA's rate design philosophy is based on receiving revenues that are commensurate with the value of the product being sold. The IOUs also argue that the PF and RL rates do not satisfy BPA's statutory obligation to establish rates of general application for requirements loads of both preference and IOU customers and the residential exchange for IOUs. *Id.* As discussed in greater detail above, BPA has established rates of general application for BPA's requirements sales to preference customers at the PF Preference rate and for sales to exchanging utilities at the PF Exchange Program rate under section 7(b)(1) of the Northwest Power Act. Also as noted above, section 7(b)(1) of the Northwest Power Act does not relate to requirements sales to IOUs under section 5(b)(1) of the Northwest Power Act at rates established under section 7(f) of the Northwest Power Act, such as the RL rate. 16 U.S.C. §839c(f); 16 U.S.C. §839e(f). Finally, the price and product for the RL sales comprise the proper consideration for BPA's proposed settlements of the REP with the IOUs.

Decision

The PF and RL rates are approximately equal rates, because one must look at the nature of the product in establishing the rate. The 24-hour flat-block sale that is the basis of the Subscription settlement proposal with the IOUs is priced at the same rate that would be paid by a preference customer purchasing the same 24-hour flat-block service. BPA's rates satisfy BPA's statutory obligation to establish rates of general application for sales to requirements loads of preference customers and for sales to exchanging utilities.

14.3 Proposed Subscription Settlements with Regional IOUs

Issue 1

Whether the proposed Subscription settlements with IOUs waive the requirements of the Northwest Power Act.

Parties' Positions

PPC argues that the Northwest Power Act established the REP, and the statutory requirements may not be waived or otherwise administratively pardoned. PPC Brief, WP-02-B-PP-01, at 64. Alcoa/Vanalco argue that although the Administrator has discretion to enter into settlements, this discretion does not extend to changing the Northwest Power Act. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92.

BPA's Position

The proposed IOU Subscription settlements have not yet been offered or executed. Such settlements are developed through a negotiation process and are not established in ratemaking proceedings conducted under section 7(i) of the Northwest Power Act. For ratemaking purposes, the general principles of the proposed settlements are consistent with the Northwest Power Act.

Evaluation of Positions

The PPC argues that the Northwest Power Act established the REP and, just as that right cannot be removed by administrative action, the statutory requirements may not be waived or otherwise administratively pardoned. PPC Brief, WP-02-B-PP-01, at 64. The PPC's specific arguments regarding the qualification of exchanging utilities for the proposed settlements are addressed in separate sections below. Alcoa/Vanalco argue that although the Administrator has discretion to enter into settlements, this discretion does not extend to changing the Northwest Power Act, citing *Morton v. Ruiz*, 415 U.S. 199, 237 (1974). Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92. Alcoa/Vanalco correctly note that BPA has discretion to enter into settlements. Section 2(f) of the Bonneville Project Act provides that:

> Subject only to the provisions of this chapter, the Administrator is authorized to enter into such contracts, agreements, and arrangements, including the amendment, modification, adjustment, or cancellation thereof and the compromise or final settlement of any claim arising thereunder, and to make such expenditures, upon such terms and conditions and in such manner as [she] may deem necessary.

16 U.S.C. §832a(f). This authority was affirmed under section 9(a) of the Northwest Power Act. 16 U.S.C. §839f(a). *See Utility Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 442-443 (9th Cir. 1989).

It is important to note, however, that while the PPC and Alcoa/Vanalco claim that the proposed settlements are inconsistent with the Northwest Power Act, BPA has not yet offered or executed any of the proposed IOU Subscription settlements. Indeed, the proposed settlements are *not* being established in the current proceeding. This proceeding is only for the establishment of rates that apply to BPA's power sales for the next five-year rate period, beginning in FY 2002, and not the contracts that implement such sales. In developing rates over the past two decades, BPA has been able to rely on existing 20-year power sales contracts developed in 1981 to forecast its sales to customers for the next rate period. This is not the case in the current

proceeding. BPA's existing power sales contracts will expire before the next rate period. Therefore, because existing contracts do not define BPA's future power sales obligations, BPA must forecast its power sales to customers for the upcoming rate period.

The proposed IOU Subscription settlements were first conceived in BPA's Power Subscription Strategy. The Subscription Strategy identified a number of basic proposed elements of the proposed settlements, but did not establish any settlements. These settlements are being negotiated with the interested IOUs, and then there will be a 30-day public comment period for all interested parties to advise BPA regarding the propriety of the proposed settlements, including the elements of the proposed settlements that PPC and Alcoa/Vanalco have identified in this rate case. After reviewing the parties' comments, the Administrator will determine whether it is appropriate to enter into the proposed settlement agreements. In developing rates, BPA must forecast sales to customers using the best information available. Because BPA has proposed to offer the IOU Subscription settlements but has not yet offered such settlements, BPA must forecast whether sales to IOUs would likely be made under those settlements. BPA's assumptions regarding the proposed settlement sales are reflected elsewhere in this ROD. While this is not the forum in which BPA will finally determine whether the proposed settlements comply with law, and a separate public process is being held to address such issues, BPA believes that the proposed settlements comply with law and will address the parties' claims.

With regard to Alcoa/Vanalco's argument that although the Administrator has discretion to enter into settlements, this discretion does not extend to changing the Northwest Power Act, *see* Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92; BPA does not believe that a conflict exists. The proposed settlements do not change the Northwest Power Act. Further, *Morton v. Ruiz* dealt with the issue of whether an agency's statutory interpretation was consistent with Congressional intent. *Id.* In the present case, BPA is not proposing any interpretation of the Northwest Power Act that is inconsistent with the intent of Congress in establishing the REP. BPA is simply proposing to offer settlements of that program as it has done over the last two decades. As noted in BPA's testimony, "[b]eginning in 1981, BPA and exchanging utilities executed RPSAs for 20-year terms. Between 1981 and today, all of these RPSAs have been settled except for one, which is between BPA and a utility in deemer status." Leathley *et al.*, WP-02-E-BPA-19, at 10-11. Again, the agency's final determination of whether any actual settlements are consistent with law will be made in a separate forum.

Alcoa/Vanalco argue that there is nothing in the Northwest Power Act that indicates that the REP will terminate or that the IOUs have the authority to settle the benefits of the REP on behalf of their residential consumers, especially in a way that would reduce or end those benefits. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92. BPA's settlement proposal does not propose to terminate the REP. The proposal simply settles the implementation of the program for participating utilities for a limited amount of time in return for appropriate consideration. The REP continues to exist for those that do not execute settlements and may continue to be implemented in its traditional form at the time any settlements expire. Contrary to the IOUs settling participation in the exchange in a way that would reduce or end those benefits, the proposed settlements are forecasted to provided greater benefits than the traditional implementation of the Exchange (compare Tr. 122 with Wholesale Power Rate Development

Study Documentation, WP-02-E-BPA-05A, at 91), although BPA has acknowledged that there are variables that could increase exchange benefits during the rate period.

With regard to whether the IOUs have the authority to settle the benefits of the REP for a limited period on behalf of their residential consumers, this is supported, as noted above, by the fact that some 21 exchanging utilities, all but one, have executed settlements over the past two decades. Leathley *et al.*, WP-02-E-BPA-19, at 10-11. In addition, the Northwest Power Act provides that the REP is implemented through contractual agreements between BPA and its utility customers. 16 U.S.C. §839c(c)(1). While benefits are passed through to residential consumers, the contractual relationship that enables the program is between BPA and the utility. The utility is a sophisticated entity with greater knowledge of the implementation of the exchange than the general public. In addition, state public utility commissions regulate IOUs. These commissions are directly involved in the REP because they establish the rate credit for the REP that is incorporated in a utility's retail rates. IOUs cannot simply discard benefits that must flow to its consumers as expressly required by law, 16 U.S.C. §839c(c)(3), particularly given the tremendous interest that state commissions take in the oversight and provision of such benefits to consumers.

Alcoa/Vanalco argue that BPA cannot settle before determining the facts through this rate case, because BPA cannot assess the prudence of the settlement in a reverse fashion. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92. As noted above, BPA has not settled the REP with the IOUs. Such settlements can occur only after negotiations with interested IOUs have concluded and BPA's public comment process on the proposed settlements has concluded. BPA must establish rates at this time, however, in order to develop rates in a timely manner and to allow customers to review BPA's proposed rates in the consideration of whether they wish to purchase power from BPA. While this means that BPA will not have perfect knowledge of its power sales in the next rate period, BPA has always been required to forecast such sales for purposes of developing rates. BPA, however, is addressing the issues raised by the parties on this matter.

Alcoa/Vanalco argue that BPA's decision to settle the REP as BPA sees fit is contrary to one of the purposes of the Northwest Power Act, which is to eliminate rate disparity between residential customers in the PNW served by preference customers and those served by the IOUs. *Id.*; *Central Electric Cooperative v. BPA*, 835 F.2d 199,200 (9th Cir. 1987). *Central Electric Cooperative*, however, does not state that elimination of *retail* rate disparity is one of the purposes of the Northwest Power Act. *Id.* Instead, this case recognized that a rate disparity grew between the retail rates paid by the customers of IOUs and the customers of publicly owned utilities, and that the REP subsidizes the rates of the exchanging utilities. *Id.* The Northwest Power Act does not state that its purpose is to eliminate the disparity of *retail* rates. The REP was established to provide IOUs a form of access to the benefits of the Federal system. This program allows IOUs to pay the same wholesale rate for power from BPA, the PF power rate, as paid by BPA's publicly owned customers, subject to the 7(b)(2) rate test. 16 U.S.C. §839e(b)(1); 16 U.S.C. §839e(b)(2). This is the rate parity provided by the Northwest Power Act. In addition, as noted above, the proposed settlements are forecasted to provided greater benefits than the traditional implementation of the exchange. Finally, the proposed settlements would not contradict the intent of the Northwest Power Act in any event, because the settlements would still provide benefits that must be passed through directly to the IOUs' residential and small farm

consumers. Alcoa/Vanalco argue that contrary to BPA's assertion, the primary purpose of the REP was not to benefit the IOUs, but to secure the benefits of cost-based BPA power for the residential and small farm customers of the IOUs by eliminating the rate disparity these consumers faced compared to the same class of consumers served by BPA's preference customers. Alcoa/Vanalco have misstated BPA's position. BPA has always maintained that the purpose of the REP was to provide a form of access to Federal power for the residential and small farm customers of exchanging utilities. The REP, however, is implemented through the utilities. Alcoa/Vanalco cite a passage from *PacifiCorp v. Fed. Energy Regulatory Comm'n*, 795 F.2d 816, 818 (9th Cir. 1986). When this quotation is viewed in context, it does not support Alcoa/Vanalco's claim. The court stated:

> Under the exchange system contemplated by section 5, each electric utility in the Northwest may elect to sell power to BPA at the "average system cost [ASC] of [a] utility's resources." 16 U.S.C. §839c(c)(1); see also 16 U.S.C. §839a(19) (defining "resource"). BPA then sells the same amount of power back to the utility at BPA's lower wholesale rate. This enables the utility to sell power to its residential customers at the priority rate given to residential consumers receiving BPA federal power. In reality the exchange is a paper transaction. It is designed to eliminate the disparity that developed between the rates paid by residential customers of the IOUs and the lower rates paid by residential customers of publicly owned utilities.

Id. The court's statement contains a number of factual errors. For example, the court states that "[t]his enables the utility to sell power to its residential customers at the priority rate given to residential consumers receiving BPA federal power." First, the utility does not sell power to its residential customers at the priority rate given to residential consumers receiving BPA Federal power. Indeed, residential customers do not pay a BPA rate for power. BPA sells power to the utility. The utility then develops its retail rates, which include expenses in addition to the cost of power at BPA's PF rate, and those retail rates are used to sell power from the utility to the residential consumer. Another factual error is the statement that the Exchange program is "designed to eliminate the disparity that developed between the rates paid by residential customers of the IOUs and the lower rates paid by residential customers of publicly owned utilities." A simple review of the Act's provisions regarding the REP shows that the Exchange does not necessarily eliminate the disparity between retail rates of IOUs and preference customers. BPA pays a subsidy to the exchanging utility based on the difference between the utility's ASC and BPA's PF Exchange rate. This amount of dollars is used to lower the retail electric bills of the consumers of exchanging utilities. The IOUs' retail rates, however, may be at a completely different level than the retail rates of a preference customer. Indeed, which retail rate of which customer could the court be referring to? Each preference customer has different retail rates, just as every IOU has different retail rates. Therefore, the REP does not eliminate retail rate disparity. Furthermore, there are some preference customers with *higher* retail rates than IOUs. The purpose of the REP was not to create parity between the residential rates of preference and exchanging customers, but rather to provide exchanging customers greater access to BPA's low-cost power. As noted previously, the term "wholesale rate parity" means exactly what it says: parity of wholesale rates charged by BPA to its preference and exchange customers. This is achieved in the Northwest Power Act by providing that the wholesale power rates for

BPA's sales to its preference customers and the wholesale power rates for BPA's sales to IOUs for the REP will be at the same rate, that is, the PF rate. This basic point, however, is not always true, because the Northwest Power Act also includes 7(b)(2), which can result in an allocation of costs such that the PF rate paid by exchanging utilities is higher than the PF rate paid by preference customers.

Alcoa/Vanalco argue that the proposed Residential Exchange settlements violate the Northwest Power Act because the 1,000 aMW sale to the IOUs does not does not fit into one of the allowed classes of power sales under that Act. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 44. This is incorrect. BPA may sell power to the IOUs under a number of authorities. BPA can sell firm net requirements power to the IOUs pursuant to section 5(b) of the Northwest Power Act. 16 U.S.C. §839c(b). BPA can sell in-lieu power to the IOUs pursuant to section 5(c). 16 U.S.C. §839c(b). BPA can sell additional power to the IOUs pursuant to section 5(f). 16 U.S.C. §839c(b). The proposed settlement sales are proposed to be net requirements sales under section 5(b) of the Northwest Power Act and therefore fit into one of the allowed classes of power sales under that Act.

Alcoa/Vanalco argue that the Residential Exchange settlement violates the intent of the Northwest Power Act that the IOU residential and small farm customers receive the same benefits from the Federal system as preference customers. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 44. Alcoa/Vanalco cite no authority for this proposition. There is no statutory requirement that the IOUs receive the same benefits from the Federal system as preference customers. Alcoa/Vanalco argue that under the settlement, IOU residential and small farm consumers will be provided greater benefits than the traditional implementation of the Exchange. *Id*. Similarly, PPC argues that BPA's proposed settlements should not provide the IOUs with more rights than are available under statute. PPC Ex. Brief, WP-02-R-PP-01, at 18. PPC also argues that settlement offers should be made only to those IOUs that qualify, given current methodologies and assumptions, for the Residential Exchange in this rate proceeding. *Id*. As noted in greater detail below, BPA has established that there are a number of variables that may affect and increase potential Residential Exchange benefits for the IOUs, and it is appropriate that these variables be taken into consideration in determining the consideration for the settlement. Boling and Doubleday, WP-02-E-BPA-53, at 20.

Alcoa/Vanalco note BPA's statements that the proposed Residential Exchange settlements are not being established in the rate case and that for ratemaking purposes, the general principles of the proposed settlements are consistent with the Northwest Power Act. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 43. Alcoa/Vanalco argue that the proposed terms of the settlements are contrary to section 7(i) of the Northwest Power Act because they have a direct impact on rates, yet parties were not permitted to comment on these topics in the rate case. *Id*. This argument is not persuasive. BPA establishes rates in a hearing consistent with section 7(i) of the Northwest Power Act. 16 U.S.C. §839e(i). BPA is not required to negotiate its contracts in a section 7(i) hearing. As noted previously, BPA has not settled the REP with the IOUs. Such settlements can occur only after negotiations with interested IOUs have concluded and BPA's public comment process on the proposed settlements has concluded. BPA must establish rates at this time, however, in order to develop rates in a timely manner and to allow customers to review BPA's proposed rates in the consideration of whether they wish to purchase power from BPA. While

this means that BPA will not have perfect knowledge of its power sales in the next rate period, BPA has always been required to forecast such sales for purposes of developing rates. For example, a virtually identical situation arose in 1981 when BPA was conducting negotiations with its customers for power sales contracts for the next (20-year) contract period. At the same time, BPA was establishing rates that would apply to sales under the contracts. BPA properly held the rate case despite the fact that the terms and conditions of the power sales contracts and RPSAs were not known and the parties could not address the contract terms in the rate case. The Administrator noted that "BPA had to consider the rate impacts of new power sales contracts, which were being negotiated with customers in separate proceedings but simultaneously with the rate hearings. The scope of the contracts and the costs of power that would be sold by BPA to its various types of customers under the new agreements *had to be projected* and taken into account in the setting of the new rates." Administrator's ROD, 1981 Transmission Rate Proposal and 1981 Wholesale Power Rate Proposal, June 1981, at i-ii (emphasis added). Additional responses to scope issues are contained in Chapter 18 of this ROD.

Alcoa/Vanalco also note BPA's statement that the proposed IOU settlements are forecasted to provide greater benefits than the traditional implementation of the Exchange. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 44. *See also* PPC Ex. Brief, WP-02-R-01, at 17. Alcoa/Vanalco, however, ignore the more detailed discussion of this issue. BPA also noted that the determination of whether a settlement for a particular IOU is appropriate will be made by BPA after negotiations with the relevant utility and after BPA's public comment process on the proposed settlement. The final decision of whether a particular settlement is excessive or insufficient will be made in that separate forum and not in the current rate case. Furthermore, BPA has established that there are a number of variables that affect potential Residential Exchange benefits for the IOUs. Boling and Doubleday, WP-02-E-BPA-53, at 20. For example, the issue of deemer balances has not yet been resolved. *Id.* If such deemer balances did not exist or were small, this would not be an impediment to receiving benefits. *Id.* Also, while BPA has used the current ASC Methodology for its rate case forecasts, the methodology could be revised. *Id.* If the methodology is revised and exchanging utilities are allowed to exchange greater costs, this would increase their ASCs and exchange benefits. *Id.* Furthermore, in-lieu transactions are dependent on resources available at lower cost than the utilities' ASCs. *Id.* Increases in market prices could reduce BPA's ability to conduct in-lieu transactions. *Id.* Also, the IOUs contest a number of assumptions BPA made in developing the proposed PF Exchange Program rate. *Id.* If BPA retains those assumptions and the IOUs successfully challenge that rate, the rate could be reduced and exchange benefits increased. *Id.* While BPA developed its 2002 power rates based on the best information available, BPA recognizes that there are variables that could allow all IOUs to receive substantial exchange benefits. *Id.*

Decision

The proposed IOU Subscription settlements have not yet been offered or executed. Such settlements are developed through a negotiation and public comment process and are not established in ratemaking proceedings conducted under section 7(i) of the Northwest Power Act. Issues regarding the consistency of the settlements with the Northwest Power Act will be addressed and determined after the public process conducted for the review of the proposed settlements. For purposes of the rate case, however, and as discussed in greater detail in this

section, BPA has determined that the proposed settlements comply with the Northwest Power Act. BPA reasonably forecasted sales under the proposed settlements.

Issue 2

Whether IOUs' net requirements are properly considered in the proposed IOU Subscription settlements.

Parties' Positions

Alcoa/Vanalco argue that part of the proposed settlement is a sale of power from BPA to the IOUs to meet part of their net requirements, but BPA does not know the IOUs' needs in the way of net requirements. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92. Alcoa/Vanalco argue that this would be arbitrary and capricious, and Federal agencies are not allowed to make decisions that violate the law. *Id.*

BPA's Position

The proposed IOU Subscription settlements have not yet been negotiated or executed. Such settlements are developed through a negotiation process and a public review process and are not established in ratemaking proceedings conducted under section 7(i) of the Northwest Power Act. BPA will not sell requirements power to IOUs that do not have a sufficient net requirement to purchase such power.

Evaluation of Positions

Alcoa/Vanalco argue that several of the individual components of the proposed exchange settlements violate the law. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 92. Alcoa/Vanalco argue that part of the proposed settlement is a sale of power from BPA to the IOUs to meet part of their net requirements, but BPA has not recently sold requirements power to the IOUs and does not know the IOUs' needs in the way of net requirements. *Id.* at 93. Alcoa argues that BPA has not yet finalized its "section5(b)/9(c) Policy," and as a result neither BPA nor the IOUs know what the IOUs' total net requirement demand will be during the rate period. *Id.* First, BPA's Subscription Power Sales to Customers and Customer's Sales of Firm Resources (policy for determining net requirements) was published on March 16, 2000. *See* BPA's Subscription Power Sales to Customers and Customer's Sales of Firm Resources, 65 Fed. Reg. 52, 14259-14265 (2000). The policy is, therefore, available to help in the determination of the net requirements of the IOUs. With regard to the argument that BPA does not know the IOUs' total net requirement demand for the rate period, this issue is addressed below. As noted previously, BPA has not yet offered or executed any of the proposed IOU Subscription settlements. Indeed, the proposed settlements are not being established in the current proceeding. This proceeding is only for the establishment of rates that apply to BPA's power sales for the next five-year rate period, beginning in FY 2002, and not the contracts that implement such sales. These settlements will be negotiated with the interested IOUs, if any, and then there will be a 30-day public comment period for all interested parties to advise BPA regarding the propriety of the proposed settlements, including arguments regarding whether the IOUs have established any

necessary net requirements. After reviewing the parties' comments, the Administrator will determine whether it is appropriate to enter into the proposed settlement agreements.

In developing rates, BPA must forecast sales to customers using the best information available. Because BPA has proposed to offer the IOU Subscription settlements but has not yet offered such settlements, BPA must forecast whether sales to IOUs would likely be made under those settlements. The total amount of benefits in the proposed IOU settlements is the equivalent of 1,800 or 1,900 aMW of power. BPA has forecasted it will offer the IOUs 1,000 aMW of firm power. The remaining 800 or 900 aMW of settlement benefits are forecasted to be in the form of monetary payments. The 1,000 aMW of power is not designated for any one utility, but would be shared by the IOUs that had established net requirements for the amount of their purchases. While these individual amounts are determined in the contract negotiations and public comment process, it is reasonable to assume that the IOUs would collectively have 1,000 aMW of net requirements. BPA forecasted 1,000 aMW of requirements sales to the IOUs during the rate period: "[f]or purposes of this Study, BPA assumes power sales to IOUs of 1,000 aMW. *See* [Loads and Resources Study, WP-02-E-BPA-01] Appendix A, Tables 6 through 10. This sales forecast assumes each of the region's IOUs participates in the REP settlement. . . . BPA assumes that Subscription power sales to the IOUs will be made as requirements sales under section 5(b) of the [Northwest Power Act] at the proposed RL rate or as 'in lieu' sales under section 5(c) of the Northwest Power Act at the proposed PF Exchange Subscription rate." Loads and Resources Study, WP-02-E-BPA-01, at 5. In any event, however, it would not matter if the IOUs have requirements that are larger or smaller than 1,000 aMW. BPA would sell power to the IOUs only within their net requirements, and if a utility could not establish a sufficient net requirement, it would not receive power but would have to receive the remaining portion of its settlement amount in the form of monetary benefits. For ratemaking purposes, the costs of the power and monetary forms of benefits are the same, so the election of one form of benefit or another does not matter.

Alcoa/Vanalco argue that possibly at least one regional IOU has no net requirements based on recent power marketing activities, yet because there is no section5(b)/9(c) Policy in place, its net requirements may not become identified until long after it has accepted requirements power sales from BPA. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 93. This circumstance will not occur. BPA's Subscription Power Sales to Customers and Customer's Sales of Firm Resources (policy for determining net requirements) was released on March 16, 2000. *See* BPA's Subscription Power Sales to Customers and Customer's Sales of Firm Resources, 65 Fed. Reg. 52, 14259-14265 (2000). The policy is therefore available to help in the determination of the net requirements of the IOUs. An obvious prerequisite for any requirements sale is the establishment of a utility's net requirements. BPA will not make net requirements sales to IOUs before BPA has determined their net requirements.

Alcoa/Vanalco argue that BPA is proposing to sell power without knowing whether any of the IOUs have net requirements. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 93. Alcoa argues that such a decision is arbitrary and capricious, citing *Motor Vehicles Mfrs. Assn. v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 43 (1983). *Id.* Again, Alcoa misunderstands what BPA is doing. A proposal to sell power is just that, a proposal. BPA's proposal is not an offer to sell power. BPA is negotiating settlement contracts with the IOUs and will hold a public comment

process before executing any requirements firm power sales. The record established in the Subscription Strategy supported a proposed settlement offer to the IOUs of benefits equivalent to 1,800 aMW of power in consideration for settlement of the REP--1,000 aMW in power, and 800 aMW in monetary benefits. This is reflected in the record developed in the current rate case. The final determination of a utility's net requirements, however, occurs in a forum outside the rate case. As noted previously, for rate case purposes BPA forecasted that collective IOU requirements would permit 1,000 aMW of requirements sales to IOUs. BPA will not sell requirements power to an IOU unless it has established a net requirement. Also, for ratemaking purposes, an IOU's election of power or monetary benefits in the 1,800 or 1,900 aMW of total benefits does not affect the development of BPA's rates. Therefore, the fact that BPA does not know a utility's final net requirement at this time does not make BPA's forecast of potential sales to such utility arbitrary or capricious. Alcoa/Vanalco argue that Federal agencies are not allowed to make substantive decisions if they have reason to believe that those decisions would violate the law. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 93. As explained previously, BPA is not determining the IOUs' final net requirements in this forum and has no reason to believe that its proposed actions would violate the law.

Decision

The proposed IOU Subscription settlements, including final determinations of net requirements, have not yet been offered or executed. Such settlements are developed through a negotiation process and are not established in ratemaking proceedings conducted under section 7(i) of the Northwest Power Act. BPA will not sell requirements power to IOUs that do not have a sufficient net requirement to purchase such power. For ratemaking purposes, BPA has reasonably forecasted 1,000 aMW of requirements sales to IOUs.

Issue 3

Whether deemer balances are properly reflected in the proposed settlements.

Parties' Positions

PPC argues that IOUs that have deemer balances should not receive cash benefits from the IOU Subscription settlements until they have paid their deemer balances. PPC Brief, WP-02-B-PP-01, at 66; PPC Ex. Brief, WP-02-R-PP-01, at 18. Alcoa/Vanalco argue that the existing power contracts between the IOUs and BPA require that the IOUs work off the deemer balances before BPA enters a new contract. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 94.

BPA's Position

The existence of deemer balances and the amount of such balances, if any, must be determined in negotiations between BPA and the IOUs. Boling and Doubleday, WP-02-E-BPA-53, at 19. This decision cannot be made in the rate case. *Id.* BPA's current assumption for ratemaking purposes is that such balances, if any, will be held in abeyance during the IOU Subscription settlement term. *Id.*

Evaluation of Positions

The PPC argues that IOUs that have deemer balances should not receive cash benefits from the settlements until they have paid their deemer balances. PPC Brief, WP-02-B-PP-01, at 66; PPC Ex. Brief, WP-02-R-PP-01, at 18. Alcoa/Vanalco argue that BPA is proposing to settle the REP with three utilities that have large deemer balances. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 94. Alcoa/Vanalco argue that BPA intends to settle with these utilities now and worry about their deemer balances later, but the existing power contracts between the IOUs and BPA require that the IOUs work off the deemer balances before BPA enters a new contract. *Id.* Alcoa/Vanalco argue that BPA intends to ignore this requirement. *Id.* BPA disagrees with the parties' arguments. BPA's estimates of IOU deemer balances are BPA's preliminary calculations and have not been discussed with or verified by the IOUs. Boling and Doubleday, WP-02-E-BPA-53, at 19. In fact, the IOUs contest BPA's calculation of the deemer balances. *Id.* The existence of deemer balances and the amount of such balances, if any, must be determined in negotiations between BPA and the IOUs and will not be finally determined until BPA and the IOUs have discussed and resolved the issue or the issue is resolved through litigation. *Id.* This decision cannot be made in the rate case. *Id.* BPA's current assumption for ratemaking purposes is that such balances, if any, will be held in abeyance during the settlement term. *Id.*

Contrary to Alcoa/Vanalco's characterization, BPA is not intending to simply settle with these utilities now and worry about the problem later. *See* PPC Ex. Brief, WP-02-R-PP-01, at 18. The deemer balances, if any, are not being forgiven by BPA. A settlement, by its very nature, is a settlement of all the issues pending between two parties regarding a particular subject matter. BPA believes that it is appropriate to assume for ratemaking purposes that the parties will include the issue of deemer balances within the proposed settlements and will hold the balance in abeyance during the term of the settlement. If utilities resume the traditional REP after the term of the settlement, the deemer issue must be resolved before the utility executes a new RPSA. Alcoa/Vanalco argue that BPA is required to operate in a business-like manner and that alleged deemer balances may be realized by BPA only at the end of the current contract period. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 45. Alcoa/Vanalco argue that BPA provides no stated purpose for not seeking to recover the alleged balances before or as part of the Residential Exchange settlements. *Id.* Alcoa/Vanalco have apparently ignored the reasons stated for BPA's position on deemer balances in this section. As noted previously and subsequently, BPA's reasons to hold any alleged deemer balances in abeyance include the preliminary nature of the alleged deemer balances; the fact that the alleged deemer balances have not been discussed with or verified by the IOUs; the fact that the IOUs contest BPA's calculation of the deemer balances; that the existence of deemer balances and the amount of such balances, if any, must be determined in negotiations between BPA and the IOUs and will not be finally determined until BPA and the IOUs have discussed and resolved the issue or the issue is resolved through litigation; and that a settlement, by its very nature, is a settlement of all the issues pending between two parties regarding a particular subject matter, including, in this case, deemer balances.

Alcoa/Vanalco argue that the existing power contracts between the IOUs and BPA require that the IOUs work off the deemer balances before BPA enters a new contract. Alcoa/Vanalco Brief,

WP-02-B-AL/VN-01, at 94. While this issue cannot be resolved in the rate case and will be addressed in the development of the proposed settlement agreements, the contract language is not as clear as implied by Alcoa/Vanalco. Section 10 of the 1981 RPSAs provides in pertinent part that "[u]pon termination of this agreement, any debit balance in such separate account shall not be a cash obligation of the Utility, but shall be carried forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement." (Emphasis added.) While BPA is not resolving this issue at this time, it is reasonable to assume for ratemaking purposes that the contract language refers to a subsequent "exchange" agreement, that is, an agreement that continues the traditional exchange of power between BPA and the utility at the respective PF Exchange and ASC rates. The proposed IOU Subscription settlement agreements; however, do not include the traditional exchange of power from the utility with power from BPA, but rather, are a payment of consideration for the termination of participation in the REP. It is appropriate in such circumstances to hold deemer balances, if any, in abeyance during the term of the settlement agreement.

Decision

BPA has properly forecasted that deemer balances will be held in abeyance for IOUs that execute Subscription settlements of the REP.

Issue 4

Whether eligibility to participate in and receive benefits from the REP is properly reflected in the proposed IOU Subscription settlements.

Parties' Positions

The PPC argues that the IOU settlement offer was made irrespective of individual IOU qualifications for, and eligibility to participate in, the REP, such that BPA has made an administrative offer in settlement of statutory rights that in some cases exceeds the statutory right available to an individual IOU. PPC Brief, WP-02-B-PP-01, at 66. Alcoa/Vanalco argue that BPA proposes to confer benefits on MPC even though MPC: (1) divested all of its generating assets in December 1999; and (2) announced it will have no obligation to serve in the post-2002 period. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 94.

BPA's Position

BPA believes there are a number of variables that affect potential Residential Exchange benefits for the IOUs. Boling and Doubleday, WP-02-E-BPA-53, at 20. While BPA developed its 2002 power rates based on the best information available, BPA recognizes that these variables could allow all IOUs to receive substantial Residential Exchange benefits. *Id.*

Evaluation of Positions

The PPC argues that the IOU settlement offer was made irrespective of individual IOU qualifications for, and eligibility to participate in, the REP, such that BPA has made an

administrative offer in settlement of statutory rights that in some cases exceeds the statutory right available to an individual IOU. PPC Brief, WP-02-B-PP-01, at 66. First, it must be noted that the determination of whether a settlement for a particular IOU is appropriate will be made by BPA after negotiations with the relevant utility and after BPA's public comment process on the proposed settlement. The final decision of whether a particular settlement is excessive or insufficient will be made in that separate forum and not in the current rate case. Furthermore, the determination of prospective participation in the REP is not as clear as suggested by PPC. As BPA has established, there are a number of variables that affect potential Residential Exchange benefits for the IOUs. Boling and Doubleday, WP-02-E-BPA-53, at 20. As just discussed, the issue of deemer balances has not yet been resolved. *Id.* If such deemer balances did not exist or were small, this would not be an impediment to receiving benefits. *Id.* Also, while BPA has used the current ASC Methodology for its rate case forecasts, the methodology could be revised. *Id.* If the methodology is revised and exchanging utilities are allowed to exchange greater costs, this would increase their ASCs and exchange benefits. *Id.* Furthermore, in-lieu transactions are dependent on resources available at lower cost than the utilities' ASCs. *Id.* Increases in market prices could reduce BPA's ability to conduct in-lieu transactions. *Id.* Also, the IOUs contest a number of assumptions BPA made in developing the proposed PF Exchange Program rate. *Id.* If BPA retains those assumptions and the IOUs successfully challenge that rate, the rate could be reduced and exchange benefits increased. *Id.* While BPA developed its 2002 power rates based on the best information available, BPA recognizes that there are variables that could allow all IOUs to receive substantial exchange benefits. *Id.*

PPC notes BPA's statement that there are a number of variables that affect a utility's ability to receive Residential Exchange benefits, including that there may be a change in the ASC Methodology during the rate period, which could increase exchanging utilities' benefits. PPC Ex. Brief, WP-02-R-PP-01, at 18. PPC argues that this argument is facetious, because BPA asserts in its Subscription Strategy that "the current ASC Methodology will be used for any Residential Exchange forecasts." *Id*., citing Subscription Strategy at 10. This argument is not "facetious." BPA's Subscription Strategy noted that, for the rate case, BPA would, in its initial proposal, propose to use the current ASC Methodology for Residential Exchange forecasts. Indeed, in the rate case BPA found it appropriate to use the current ASC Methodology for Residential Exchange forecasts. This is perfectly consistent, however, with BPA's recognition that a new ASC Methodology could be established during the rate period that could increase exchanging utilities' benefits. While BPA does its best to make forecasts, BPA must recognize that there are things that BPA cannot now determine with certainty.

Alcoa/Vanalco argue that BPA proposes to confer benefits on MPC even though MPC: (1) divested all of its generating assets in December 1999; and (2) announced it will have no obligation to serve in the post-2002 period (Tr. 1571, lines 17-23; Tr. 1680, line 24; Tr. 1681, line 3. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 94. Alcoa/Vanalco argue that BPA does not yet know how it will supply any benefits obtained from the settlement to a utility that has no power supply costs, Tr. 1571, line 17, through 1575, line 2. *Id.* First, Alcoa/Vanalco's citations to the record do not precisely correspond with their characterizations of the testimony. The transcript citations in support of the claim that MPC announced that it will have no obligation to serve in the post-2002 period do not reference FY 2002 or any other year but note that it was the witness's "impression" that MPC did not intend to remain in the power supply business.

Tr. 1681, lines 2-3. A utility's intent may not coincide with what a utility is required to do by law. In addition, as noted previously, these types of issues are issues that will be addressed in the negotiation of the IOU Subscription settlement agreements. The proposed settlement agreements would then be subject to a public process where interested parties could raise issues regarding the proposed settlements, including the issue identified by Alcoa/Vanalco.

For ratemaking purposes, BPA believes it is reasonable to include a forecast of settlement benefits to MPC in the rate case for a number of reasons. For example, Alcoa/Vanalco fail to note a number of significant points regarding MPC. Regardless of whether or not BPA has a policy for serving utilities that may have divested resources, there is a substantial basis for assuming that MPC would continue to have an obligation to serve residential loads during the rate period. MPC may have an obligation to serve, in which case it would have to acquire resources or use the resources it sold pursuant to a contract right. First, under Montana law, by default MPC continues to 2002 to supply retail load or consumers that do not elect to purchase from other suppliers. Mont. Code Ann. section 69-8-201(1)(b); *Id.* at (3); section 69-8-103(25). In addition, the law allows the public utilities commission to extend to 2004 the transition period wherein MPC would likely continue as the default supplier. Mont. Code Ann. section 69-8-201(2)(a). In addition, the State of Montana has passed a statute establishing a default supplier that will serve residential loads. Mont. Code Ann. section 39-19-101 to 315. While MPC or another entity may become the default supplier under that statute at any time, there is no requirement to establish a default supplier under that statute until the end of the transition period under the Montana restructuring statute. Mont. Code Ann. section 39-19-103. Where MPC is the default supplier, it would be an exchanging utility serving residential load during the rate period. It would, therefore, be a proper participant in an exchange settlement.

While Alcoa/Vanalco question how benefits obtained from the settlement would be provided to a utility that has no power supply costs, MPC would need to acquire power to serve its load obligations. MPC would then have power supply costs. Such costs could be the basis for MPC's proposed ASC. Finally, as noted above, Alcoa/Vanalco admit that MPC has an obligation to 2002, which is within the rate period. BPA's Subscription Strategy proposes that the exchange settlement benefits must be able to be assigned to the party serving the residential load. *See* Subscription Strategy at 9. Thus, even if MPC were no longer the supplier, it is likely that another eligible entity would be able to have the settlement benefits assigned to them.

Alcoa/Vanalco argue that MPC has announced that it will sell its transmission assets and expects to be out of the power supply business within one to one and one-half years. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 45-46. Alcoa/Vanalco have not identified any record support or other authority for this proposition. In any event, however, BPA understands that MPC plans to make MPC a subsidiary of Touch America and sell the company stock for the subsidiary to new owners. Sale of the company through a stock sale would transfer the existing obligations of the company under Montana statutes to the new owner. Alcoa/Vanalco also argue that BPA's reliance on Montana law for the proposition that MPC has a continuing obligation to serve as the default supplier misconstrues the present state of the electricity market and law in Montana. *Id*. BPA disagrees. Montana's restructuring statute requires MPC or its successor to provide a default supply service during a transition period through 2002. The public service commission may extend such transition period until 2004 under the statute. While the public service

commission is authorized by a subsequent statute to appoint another entity as the default supplier other than MPC, they are not required to make such appointment until the end of the transition period in the restructuring statute. Alcoa/Vanalco argue that at this time, the Montana Public Service Commission has not designated a permanent default supplier and MPC has made clear by its actions (sale of power and transmission assets) that it cannot and will not be designated as the default supplier. *Id*. BPA disagrees with Alcoa/Vanalco that MPC has made it clear by its actions that MPC or its successor will not be serving residential load during the period starting October 1, 2001. While MPC management has made clear its obligation to change managers and owners of MPC, the successors to the company will have the obligation to serve the current residential consumers of MPC. There is a high likelihood that the PSC will ultimately select the owner of the distribution system, *i.e.*, MPC's successor, as the default supplier for MPC's current residential consumers. BPA believes MPC still represents the interests of MPC's residential consumers under Montana statutes until it transfers ownership of the company. There are still many unresolved issues around the sale of the company that could result in the sale not being closed.

Given Alcoa/Vanalco's previous arguments, they argue that BPA has no reasonable basis to assume that MPC will be in any position to receive the Residential Exchange settlement proceeds and pass them on to any eligible customer. *Id*. BPA disagrees with Alcoa/Vanalco's characterization of the current situation. MPC still has obligations to its residential consumers under Montana law. BPA has no evidence that MPC does not intend to fulfill those obligations. It is reasonable for BPA to believe that MPC or any successor will meet the needs of the residential consumers of Montana. Further, Alcoa/Vanalco argue that there is no evidence that any successor to MPC would be eligible to receive these proceeds. *Id*. The eligibility of a successor to MPC to receive benefits under the REP is a statutory question. BPA believes the intent of Congress under section 5(c) is that benefits of the Federal Columbia River Power System are intended to flow to residential consumers. Congress established the REP in a manner that the benefits flowed to those consumers through their electricity supplier. BPA believes that "Pacific Northwest electric utilities" for purposes of section 5(c) are those entities serving the residential and small farm loads of the region as authorized by state law or order of the applicable state regulatory authority. BPA sees no intent of Congress to exclude residential consumers from receiving the benefits of the FCRPS based on how a state structures its electric power industry, and no evidence to conclude that any successor to MPC would be ineligible to receive Residential Exchange settlement proceeds. Alcoa/Vanalco argue that BPA's decision to include the cost of any Residential Exchange settlement with MPC in BPA's revenue requirement in this rate case is not supported by the record. *Id*. To the contrary, BPA's legal and other analysis of this issue has been addressed previously. Furthermore, Alcoa/Vanalco have presented no evidence that residential consumers of MPC will cease to exist or that those consumers will not be eligible for benefits under the REP. BPA believes MPC still represents the interests of MPC's residential consumers under Montana statutes until it transfers ownership of the company. MPC is still capable of entering a contract on behalf of those consumers.

Decision

While BPA has developed its 2002 power rates based on the best information available, BPA recognizes that there are variables that could allow all IOUs to receive substantial Residential Exchange benefits. BPA properly reflected an amount of settlement benefits for MPC.

Issue 5

Whether BPA has properly reflected in ratemaking the possible increase in proposed IOU Subscription settlement benefits from 1,800 to 1,900 aMW.

Parties' Positions

The PPC argues that BPA's other customers should not bear the cost of the extra 100 aMW of IOU benefits that BPA is currently considering, suggesting either a 1,800 aMW limit on settlement benefits or purchasing and melding the cost of 100 aMW in the IOUs' rates. PPC Brief, WP-02-B-PP-01, at 67; PPC Ex. Brief, WP-02-R-PP-01, at 18-19. SUB argues that the proposed sales of an additional 100 aMW at a PF equivalent rate will increase the risk that preference customers will pay a higher rate. SUB Brief, WP-02-B-SP-01, at 7; SUB Ex. Brief, WP-02-R-SP-01, at 8.

BPA's Position

BPA is currently taking public comment on whether BPA should increase the proposed settlement amount by 100 aMW. Doubleday *et al.*, WP-02-E-BPA-44, at 13-14. The decision as to whether to increase the settlement amount will be made in a forum separate from the current power rate case. *Id.* BPA proposed an appropriate method of allocating the costs of the proposed IOU settlements. *Id.* BPA stated that it was willing to consider increasing the IOU settlement amount from 1,800 to 1,900 aMW as long as BPA's goal not to increase the average PF rate over present levels could be met; it would not require BPA to reduce its TPP; it would not require a change in the DSI proposal; and there would be no impact on BPA's ability to meet its fish and wildlife commitments. Burns and Elizalde, WP-02-E-BPA-37, at 7. After BPA filed its rebuttal, BPA concluded a separate forum in which BPA proposed to increase the IOU settlement amount from 1,800 to 1,900 aMW. Subscription Supplemental ROD, at 11-23. REP settlement costs are equitably allocated between the PF Preference class and the RL class. *See* Doubleday *et al.*, WP-02-E-BPA-18, at 17-18; and Doubleday *et al.*, WP-02-E-BPA-44, at 13.

Evaluation of Positions

The PPC argues that BPA's other customers should not bear the cost of the extra 100 aMW of IOU benefits that BPA is currently considering. PPC Brief, WP-02-B-PP-01, at 67; PPC Ex. Brief, WP-02-R-PP-01, at 18-19. PPC argues that BPA should either lower the proposed allocation to the 1,800 aMW proposed in the Subscription Strategy, or purchase the additional 100 aMW of benefits at market rates and meld the cost into that of the 1,800 aMW so that the IOUs bear this additional cost. *Id.* SUB argues that the sale of the 100 aMW increases BPA's

need to purchase power on the market to meet preference customer load growth, resulting in an increased likelihood of triggering a CRAC, which would result in a higher rate for preference customers. SUB Brief, WP-02-B-SP-01, at 7. In response to the suggestion that BPA should increase the proposed settlement amount from 1,800 to 1,900 aMW, BPA noted that BPA would consider adding the additional 100 aMW as long as BPA's goal of not increasing the average PF Preference rate over present levels could be met, no change in TPP is required, no change in the DSI rate proposal is required, and there is no impact on BPA's ability to meet its fish and wildlife commitments. Doubleday *et al.*, WP-02-E-BPA-44, at 13-14; *see* Burns and Elizalde, WP-02-E-BPA-08, at 12. These conditions provide significant protection to BPA's preference customers. BPA previously noted that it was taking public comment on whether BPA should increase the proposed settlement amount by 100 aMW. Doubleday *et al.*, WP-02-E-BPA-44, at 14. BPA noted that the decision as to whether to increase the settlement amount would be made in a separate forum. *Id.* In the Draft ROD, BPA concluded that to the extent that the increase could be achieved consistent with the above noted conditions, it would be appropriate to reflect 1,900 aMW, not 1,800 aMW, as the IOUs' proposed settlement benefits in order to ensure that BPA's rates are established in a manner that would recover BPA's costs. In other words, if BPA included only 1,800 aMW for ratemaking purposes, but actually provided 1,900 aMW, BPA would incur costs during the rate period that were not incorporated in BPA's rates.

PPC argues that BPA's assumption of 1,900 aMW as the amount for the IOU settlements is inconsistent with the practice of using current methodologies and assumptions in modeling rates. PPC Ex. Brief, WP-02-R-PP-01, at 18. In fact, however, BPA recently completed the public comment process noted above and released its Power Subscription Strategy Administrator's Supplemental ROD. In that document, BPA reviewed public comments on the issue of whether the IOU settlement amount should be 1,800 aMW or 1,900 aMW. After BPA's review of such comments, BPA determined that 1,900 aMW be proposed as the amount of the IOU Subscription settlement benefits. Subscription Supplemental ROD, at 11-23.

SUB argues that BPA erred in the Draft ROD because the additional 100 aMW above the 1,800 aMW identified for the IOU Subscription settlements must be met by augmentation, which increases the risk that BPA will underrecover its costs, causing the CRAC to trigger and increasing rates for BPA's preference customers. SUB Ex. Brief, WP-02-R-SP-01, at 8. BPA disagrees. Due to the high demand for BPA power, it is extremely unlikely that the additional 100 aMW would be met with augmentation purchases. It is likely that the additional 100 aMW would be met with monetary settlement payments. By reflecting these costs in BPA's rates, BPA will avoid underrecovery of costs or increasing the likelihood of CRAC triggering. SUB also argues that the Subscription Strategy ROD identifies 1,800 aMW as the cost-based benefit to the IOUs. *Id.* As noted previously, BPA's Subscription Strategy Administrator's Supplemental ROD decided the increase of IOU settlement benefits from 1,800 aMW to 1,900 aMW. SUB quotes a passage from the Subscription ROD to the effect that, at the time the Subscription Strategy was prepared, BPA had a limited inventory of power and BPA limited the amount of power sales to the IOU settlements. SUB argues that the Subscription Strategy would require BPA to have or acquire excess inventory to meet the provision of benefits above 1,800 aMW. *Id.* Again, however, it is BPA's expectation that the additional 100 aMW would likely not be met with augmentation purchases, but rather would be met with monetary settlement payments.

With regard to the suggestion that BPA should purchase power and meld the cost in with the cost of the 1,800 aMW, this would be inappropriate; BPA proposed an appropriate method of allocating the costs of the proposed IOU settlements. Doubleday *et al.*, WP-02-E-BPA-44, at 14. Simply because the amount is increased by 100 aMW does not mean that these costs should be treated differently. *Id.* As noted in BPA's direct testimony, REP settlement costs are equitably allocated between the PF Preference class and the RL class. *See* Doubleday *et al.*, WP-02-E-BPA-18, at 17-18. This is appropriate, because this allocation results in a rate level for the settlement sales that supports the proposed value of the settlement of the REP with regional IOUs. Doubleday *et al.*, WP-02-E-BPA-44, at 13. This allocation also helps to promote the wide and diversified use and distribution of Federal power. *Id.*

Decision

The decision as to whether to increase the IOUs' settlement amount has been made in a separate forum. That forum has now decided to propose 1,900 aMW as the total amount of IOU settlement benefits. BPA has concluded that this increase can be achieved consistent with the above-noted conditions. It is appropriate to reflect 1,900 aMW as the IOUs' proposed settlement benefits in order to ensure that BPA's rates are established in a manner that would recover BPA's costs. BPA uses an appropriate method of allocating the costs of the proposed IOU settlements.

Issue 6

Whether the rates for IOU Subscription settlements should reflect charges applicable to the PF Preference rate.

Parties' Positions

The PPC argues that the loads of preference customers are subject to charges and adjustments in addition to the PF rate, and that an equitable solution would be to eliminate such charges and adjustments from the PF rate or assess comparable charges to the RL rate. PPC Brief, WP-02-B-PP-01, at 65; PPC Ex. Brief, WP-02-R-PP-01, at 16.

BPA's Position

The RL and PF Exchange Subscription rates do not include the TAC or other similar charges, because all settlement sales must be concluded during the Subscription window and are provided in a prescribed amount and shape. Doubleday *et al.*, WP-02-E-BPA-44, at 13.

Evaluation of Positions

The PPC argues that BPA's Subscription Strategy stated that the IOU settlement power should be charged a "PF-equivalent" rate rather than the NR rate, and that this rate is inconsistent with BPA's proposal for preference customers and therefore is not a "PF-equivalent" rate. PPC Brief, WP-02-B-PP-01, at 65. PPC argues that this is so because the loads of preference customers are subject to charges and adjustments in addition to the PF rate, and that an equitable solution

would be to eliminate such charges and adjustments from the PF rate or assess comparable charges to the RL rate. *Id.* First, proposed settlement sales to the IOUs are made under the RL and PF Exchange Subscription rates. Doubleday *et al.*, WP-02-E-BPA-44, at 13. BPA's Subscription Strategy did not state that the IOU settlement sales would be charged a "PF-equivalent" rate, but rather that BPA expected the rate to be "approximately equal" to the PF Preference rate, and the rate would be subject to establishment in a section 7(i) hearing. *See* Subscription Strategy at 16. BPA's statements in the Subscription Strategy and ROD were not final rate decisions, which can be made only in a section 7(i) hearing process. 16 U.S.C. §839e(i). BPA's discussions on rate issues in the Subscription process were limited to discussions of what might be included in BPA's initial proposal and then might be subject to change in the formal hearing.

Furthermore, BPA's general statement that IOU settlement sales will be at a rate "approximately equal to the PF Preference rate" (subject to the above-noted conditions) does not require the application of the noted charges to the RL rate. The Subscription Strategy spoke in general terms about the level of the RL and PF Preference rates. The Subscription Strategy did state, however, that rates for sales to public agency customers made after the Subscription window closes would be subject to a "targeted adjustment charge." *See* Subscription Strategy, at 15. The Subscription Strategy did not state that such a charge would apply to the RL or PF Exchange Subscription rates. Further, the Subscription Strategy did not say that the RL rate would be eligible for all of the same rate adjustment features of the PF Preference rate. Indeed, this is consistent with the fact that the RL rate is not subject to a number of charges that apply to the PF Preference rate, such as the TAC, TACUL, SUMY, and other charges. This is because such settlement sales must be established during the Subscription window and are for a fixed amount and shape of power during the rate period. Doubleday *et al.*, WP-02-E-BPA-44, at 13. For example, the RL and PF Exchange Subscription rates do not include the TAC because all IOU settlement sales must be concluded during the Subscription window. *Id.* Other charges to the PF Preference rate are not applicable to the settlement sales for similar reasons. *Id.*

PPC argues that it does not find any distinction between its characterization of the RL rate as "PF-equivalent" and BPA's characterization of the RL rate as "approximately equal to the PF rate." PPC Ex. Brief, WP-02-R-PP-01, at 16. This distinction is discussed in greater detail above. One of BPA's primary points, however, is that the Subscription Strategy did not provide that the RL and PF rates would be *equivalent*, as suggested by PPC, because there are differences in the products available under the rates and such differences do not support the application of certain charges and adjustments to the RL rate. PPC also argues that, in effect, RL customers are given preference to BPA's lowest cost-based rates in a manner that is superior to that proposed for preference customers. BPA disagrees. BPA's power sales to IOUs at the RL rate are for 24-hour flat-block power only. Furthermore, while purchasers of power at the RL rate are not subject to charges that do not apply because of the type of power provided, BPA's preference customers have access to the full panoply of products available at the PF Preference rate. BPA's application of the RL rate to the IOU settlements is not superior to preference customers' purchases of a variety of products at the PF Preference rate. Furthermore, it is worth noting that if a preference customer were to purchase the product being offered to the IOUs under the proposed settlements, it would pay exactly the same rate for such power.

Decision

The issue of whether BPA should eliminate charges and adjustments from the PF Preference rate is addressed in ROD chapter 11. The rates for IOU Subscription settlement sales are not subject to the charges and adjustments that apply to PF Preference rate sales; such charges and adjustments are not used in the calculation of the RL and PF Exchange Subscription rates.

Issue 7

Whether the duration of the proposed IOU Subscription settlement agreements is reasonable compared to the duration of the proposed RPSAs.

Parties' Positions

PPC argues that the proposed IOU Subscription settlements are enriched by the duration of their offered term. PPC Brief, WP-02-B-PP-01, at 67; PPC Ex. Brief, WP-02-R-PP-01, at 19.

BPA's Position

The establishment of the terms of the IOU Subscription settlements and the RPSAs is a contract negotiation matter that will not be resolved in the rate case. BPA's prototype RPSAs and IOU settlement agreements permit terms up to ten years. The IOU settlements are not enriched by the duration of their term.

Evaluation of Positions

The PPC argues that the proposed IOU Subscription settlements are enriched by the duration of their offered term. PPC Brief, WP-02-B-PP-01, at 67. The PPC argues that IOUs may select up to ten years of benefits through this settlement, a term potentially longer than a contract for participation in the REP. *Id.* PPC cites no basis upon which it concludes that the duration of the proposed settlements would differ from the duration of the proposed RPSAs. Furthermore, BPA has not yet completed negotiations, or offered or executed any of the proposed IOU Subscription settlements or RPSAs. Indeed, the terms of the proposed settlements and RPSAs are not being established in the current proceeding. This proceeding is only for the establishment of rates that apply to BPA's power sales for the next five-year rate period, beginning in FY 2002, and not the contract provisions that implement such sales. In any event, however, BPA has issued a letter requesting comments on its prototype RPSAs and IOU settlement agreements. The prototype RPSA is offered for a term up to ten years. The prototype IOU settlements are available for either a five year or a ten year term. While these terms are not yet final, BPA's prototype RPSA and IOU settlement agreements provide the same potential ten year duration for both types of contracts. This does not enrich the IOU settlements over the RPSAs.

PPC argues that in light of recent Congressional efforts to phase out the REP (citing H.R. Rep. No. 293, 104th Cong., 1st Sess. 92 (1995)), its argument that benefits under the IOU settlements are enriched by the duration of the offered term (ten years) is not speculative. PPC Ex. Brief, WP-02-R-PP-01, at 19. PPC argues that any settlement that provides benefits beyond the

FY 2002-2006 rate period unduly enriches the settlement, because there is no evidence that benefits under the traditional REP would extend past 2006. *Id*. First, the authority cited by PPC is comprised of comments in a House report, not an actual change in legislation. While the comments were made five years ago, the REP is still in existence. In addition, the previous Residential Exchange agreements were in effect for 20-year terms. BPA's proposed RPSAs, which will implement the REP in the next contract period, are for up to a 10-year term. While it is possible that the REP could be terminated by new legislation, such legislation is still speculative. Similarly, the contracts could address the termination of the contract in the event of such legislation. In summary, BPA believes that a ten year term for the IOU settlements is appropriate for rate development purposes.

Decision

While BPA has not yet offered or executed any of the proposed IOU Subscription settlements or RPSAs, and the terms of such contracts are not established in this rate proceeding, BPA has released prototypes for public comment that provide the same duration for both contracts. Thus, the proposed settlements are not enriched by a potentially longer term.